[St. John's Law Review](https://scholarship.law.stjohns.edu/lawreview)

Volume 18, April 1944, Number 2 Article 14

Securities Act--Sale of Securities Over-the-Counter at Higher Than Prevailing Market Prices--Revocation of Broker's Registration (Charles Hughes & Company v. Securities and Exchange Commission, 139 F.2d 434 (2d Cir. 1943))

St. John's Law Review

to be put. The circumstances surrounding the check were suspicious enough so that the bank was under a duty to inquire as to the extent of the authority of *C*. Courts throughout the country are uniform on the liability of the bank and third persons in similar cases,[13] with the present decision an expansion of that doctrine. It is sweeping in its effect and overrules previous limitations established by the court. No matter how slight may be the grounds for suspicion, nor how misleading the acts of the agent, where the check is made out to the order of the defendant and delivered to him by a third person who has received it from the maker, the court places upon the defendant a duty to inquire. Before he accepts such a check, he must be certain it was intended for his use. Should he disregard inquiry, he will be liable in conversion if the agent acted without authority.

K. B.

SECURITIES ACT—SALE OF SECURITIES OVER-THE-COUNTER AT HIGHER THAN PREVAILING MARKET PRICES—REVOCATION OF BROKER'S REGISTRATION.—Petitioner, an over-the-counter dealer and broker in securities, after two hearings before the Security Exchange Commission, had his license revoked for fraud and deceit in violation of Section 17(a) of the Securities Act,[1] Section 15(c)(1) of the Securities Exchange Act,[2] and the Commission's own Rule X-15C1-2.[3] The dealer's methods of operation were as follows: Prospects, usually single women or widows with little knowledge of financial transactions, were called to the 'phone or visited in their homes. They were told of a "wonderful stock", a "marvelous buy", one that was "beyond the usual". High pressured salesmanship gradually broke down any resistance, instilled trust and confidence. Sales were effected at mark-ups ranging from 16.1 per cent to 40.9 per cent above prevailing market prices without any disclosure of real values and with little or no risk to the firm involved.[4] Petitioner contended (1) that Section 15(c)(1) of the Act was unconstitutional and Rule X-15C1-2 invalid for vagueness, indefiniteness, and uncertainty; (2) that no violation of Section 17(a) had been shown; and (3) that the Commission had not offered substantial evidence of current market levels. *Held,* order affirmed. The standards for interpreting the Act are set up within the Act itself and are more than adequate. They make for more definiteness than the standards approved by

[13] See notes 1, 3, 4, 7, 10, *supra.*

[1] 48 STAT. 84, 15 U. S. C. § 77q (1933).

[2] 52 STAT. 1075, 15 U. S. C. § 78O(c)(1) (1938).

[3] Acting under its rule-making power, the Commission set up a two-fold definition of the term "manipulative, deceptive, or otherwise fraudulent" in its rule X-15 C 1-2.

[4] The Commission investigated twenty-seven separate transactions of the respondent: in six, mark-ups were 30%; in seventeen, 21%-30%; and in four, 16%-20%, above prevailing market prices.

the Supreme Court in *Buttfield v. Stranahan* [5] and in numerous other cases. Rule X-15C1-2 must be sustained because its wording is almost identical with that of Section 17(a), already upheld against any claims of vagueness.[6] Petitioner violated Section 17(a) in a threefold manner: *i.e.,* by obtaining money "by means of any untrue statement of facts," by "omission to state a material fact," and finally by engaging in a course of business which operated "as a fraud and deceit upon its purchaser." *Charles Hughes & Company v. Securities and Exchange Commission,* 139 F. (2d) — (C. C. A. 2d, 1944).

Over-the-counter dealers who sell securities so out of line with market values as in the instant case are deemed to commit a fraud upon the confiding and untutored public. After customers' confidence has been obtained, brokers are under a special duty not to take advantage of non-professional traders or uninformed investors. Nondisclosure of excessive mark-ups [7] is both a failure to state a material fact and a fraudulent device. "The law of fraud knows no difference between express misrepresentation on the one hand and implied misrepresentation or concealment on the other".[8] Stock trading is a highly technical and complicated business. Over-the-counter markets are mostly unorganized; opportunities for dishonesty are "of constant recurrence and ever present," and Congress itself in enacting the Securities Act of 1933 regarded securities as "intricate" merchandise.[9] The primary purpose of securities legislation is to protect the ignorant and unwary from the over-reaching and manipulations of the expert, as well as to prevent fraud by precluding the sale of "securities which are in fact worthless or worth substantially less than the asking price".[10] The old rule of *Caveat Emptor* should not be permitted to reward deception and fraud;[11] rather, the new rule enunciated by the President in introducing this legislation to Congress should prevail, *viz., "let the seller also beware"*.[12] If the public cannot place

---

[5] Buttfield v. Stranahan, 192 U. S. 470, 24 Sup. Ct. 349, 48 L. ed. 525 (1904).

[6] Coplin v. United States, 88 F. (2d) 652, *cert. denied,* 301 U. S. 703, 57 Sup. Ct. 929, 81 L. ed. 135 (1937).

[7] The price policies of the Commission may be gleaned by reading *In the Matter of* G. Alex Hope, 7 S.E.C. 1082, 1084 (1940). "It is not, of course, the amount of the profit *per se* which we condemn . . . the fraud lay not in the amount of the profit realized, but in the inherent misrepresentation as to the current market price of the security." *See In the Matter of* Allender & Co., Inc., 9 S.E.C. 1043, 1056 (1941); S.E.C. v. Torr, 15 F. Supp. 315 (1936), *rev'd,* 87 F. (2d) 446 (1937).

[8] Strong v. Repide, 213 U. S. 419, 29 Sup. Ct. 521, 53 L. ed. 853 (1909); cf. United States v. Brown, 79 F. (2d) 321, *cert. denied,* 296 U. S. 650 (1935).

[9] H. R. REP. No. 85 (1939) 8.

[10] People, *etc.* v. Federated Radio Corp., 244 N. Y. 33, 154 N. E. 655 (1926).

[11] Federal Trade Comm. v. Standard Educational Soc., 302 U. S. 112 (1937).

[12] President Roosevelt, in his message to Congress recommending the Securities Act of 1933, stated: "This proposal adds to the ancient rule of *Caveat Emptor* the further doctrine 'let the seller also beware'. It should give impetus to honest dealing in securities and thereby bring back public confidence."

confidence in a commission-licensed broker, such legislation would defeat its own purpose and be little more than a snare and delusion. The Commission has consistently held that the dealer in securities is bound not to engage in fraudulent transactions, that he must not charge prices which bear no reasonable relation to prevailing market prices without disclosing such fact, and that by reason of the very nature of his business, the security dealer impliedly represents to his customers that he will deal with them fairly and honestly, and live up to the high ethical standards of his business colleagues.[13]

Fraud in its especial application to the field of securities has been profoundly considered by State Securities Commissions and by the courts. In New York this was in construing the Martin Act, while similar thought has been given the subject in Illinois,[14] Massachusetts,[15] Indiana,[16] Kansas,[17] Texas [18] and Missouri.[19] These authorities regard the securities dealer in the light of an expert or professional, dealing with one inexpert, so that the nature of his position and his knowledge impliedly represent that all his transactions accord with the high standard of his profession, analogous to that of a lawyer,[20] doctor,[21] architect, public weigher,[22] *etc.* This principle has consistently embodied the policies of the Securities Exchange Commission, and this is the first case brought into a Circuit Court of Appeals attempting to challenge it. Confidence is still the corner-stone of business; honesty is still the best policy; and at least in the field of securities, the somewhat harsh rule of *Caveat Emptor* has by statute been relegated to the dim obscurity of the "ancient lights". A newer legal concept is beginning to be crystallized in the new doctrine, *"let the seller also beware"*.

H. M.

---

[13] *In the Matter of* G. Alex Hope, 7 S.E.C. 1082 (1940); Duker v. Duker, 6 S.E.C. 386 (1939).

[14] Within the meaning of the Illinois Securities Act, a dealer's registration was revoked for taking extremely high profits running in one case to 25%. Such conduct was characterized as "taking grossly unfair advantage of a customer".

[15] Birch v. Arnold & Sears, Inc., 288 Mass. 125, 192 N. E. 591 (1934).

[16] Farnet v. Hunt, 189 Ind. 45, 124 N. E. 745 (1919).

[17] Fourth Nat. Bank v. Webb, 131 Kan. 167, 290 Pac. 1 (1930).

[18] McDonald v. Lestinger, 214 S. W. 829 (Tex. Civ. App. 1919).

[19] Raisel v. Winsor, 140 Mo. App. 612, 120 S. W. 1186 (1919).

[20] *In re* Goldstone, 214 Cal. 490, 6 P. (2d) 513 (1931); State v. Barto, 202 Wis. 329, 232 N. W. 553 (1930).

[21] Wilcox v. Carroll, 127 Wash. 1, 219 Pac. 34 (1923).

[22] Glanz v. Shepard, 233 N. Y. 236, 135 N. E. 275 (1922).